

GENERAL FUND REVENUE AND FUND BALANCE UPDATE FISCAL 2009

A Report Prepared for the
**Revenue and Transportation Interim Committee
Legislative Finance Committee**

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July 27, 2009

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INTRODUCTION

The purpose of this report is to provide the committees with the final (unaudited) information on general fund revenue collections and a preliminary ending fund balance for FY 2009. A detailed analysis has not been included in this report but will be provided in the September/October timeframe. The reason for not preparing a detailed analysis at this time is because considerable research would be required to determine what new revenue trends observed in FY 2009 will impact revenue collections in the 2011 biennium.

During the regular legislative session, our office recommended to the 61st Legislature that the general fund revenue estimates be decreased by \$292.6 million for fiscal 2009, 2010, and 2011. The House Taxation Committee adopted these recommendations and included the assumptions in HJ 2, the revenue estimating resolution. The reduced revenue was anticipated from major sources such as individual and corporation income taxes and oil and gas production taxes. As indicated in the July 1st revenue report, final collections for FY 2009 would not be available until the end of July when all the year-end adjustments (accruals) have been posted to the state accounting system. The FY 2009 accounting records are now closed and the numbers presented in this report reflect the final revenue and fund balance information for FY 2009. The Legislative Auditor will be auditing the FY 2009 records and presenting their findings in December 2009.

GENERAL FUND REVENUE AND FUND BALANCE

FISCAL 2009 REVENUE COLLECTIONS

Based on information recorded on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts for FY 2009 were \$1.808 billion as shown in Figure 1. This compares to \$1.954 billion collected for FY 2008. This is a decline in collections from FY 2008 of \$145.6 million or a 7.5 percent decrease. It is important to note that the collections for FY 2009 are preliminary amounts and are subject to audit by the Legislative Auditor. The legislative audit report will be released in December 2009.

Total general fund collections as estimated by the legislature were expected to be \$108.9 million (5.6 percent) below the FY 2008 actual collections. These estimates were used by the 61st Legislature and contained in the adjusted HJ 2 (revenue estimate resolution plus impacts of enacted legislation). Most of this reduction was expected from insurance premium tax, individual income tax, oil and gas production tax, and TCA (treasury cash account) investment earnings. Insurance premium tax collections were expected to decline because of the passage of I 155, Montana Healthy Kids Initiative, and the statutory changes adopted in HB 676 of the regular session. Individual income tax collections were expected to decline because of the economic recession impacts on wage and salary income, capital gains income, and many of the other taxable income components. Oil and gas production collections were expected to decline because of significantly reduced commodity prices and reduced production levels. TCA investments earnings were expected to decline because of the historical low level for short-term interest rates.

As shown in Figure 1, total general fund collections for FY 2009 were \$36.6 million (2.0 percent) below the estimates used by the legislature in the adjusted HJ 2 resolution. Figure 1 shows revenue collection and estimate data by major revenue category. The last two columns in the figure show how collections from the revenue source performed when compared to the estimate contained in HJ 2. For example, insurance tax (2nd line) shows a positive \$160 thousand in the "2009 Difference" column. This means collections were \$160 thousand greater than the estimate contained in HJ 2 for a 0.32 percent difference shown in "2009 %" column. Conversely, individual income tax shows a negative \$37.5 million in the difference column (4.4 percent). This means collections were \$37.5 million below the adjusted HJ 2 estimate for a negative 4.4 percent difference.

Figure 1

General Fund Revenue Monitoring Report					
Revenue Source	Actual Fiscal 2008	HJ2 Estimate * Fiscal 2009	Actual Fiscal 2009	2009 Difference From Estimate	2009 % Difference
GF0100 Drivers License Fee	3,865,872	4,667,000	3,478,285.28	(1,188,714.72)	-25.47%
GF0200 Insurance Tax	64,003,987	49,878,000	50,038,468.37	160,468.37	0.32%
GF0300 Investment Licenses	6,513,962	6,127,000	6,461,445.88	334,445.88	5.46%
GF0400 Vehicle License Fee	93,493,069	93,493,000	89,334,878.17	(4,158,121.83)	-4.45%
GF0500 Vehicle Registration Fee	18,992,762	18,926,000	15,343,404.10	(3,582,595.90)	-18.93%
GF0600 Nursing Facilities Fee	5,610,099	5,318,000	5,468,765.81	150,765.81	2.84%
GF0700 Beer Tax	3,124,238	3,160,000	3,114,729.33	(45,270.67)	-1.43%
GF0800 Cigarette Tax	36,004,249	34,564,000	34,320,412.46	(243,587.54)	-0.70%
GF0900 Coal Severance Tax	11,894,408	12,410,000	13,028,227.80	618,227.80	4.98%
GF1000 Corporation Tax	160,341,787	157,284,000	166,354,514.25	9,070,514.25	5.77%
GF1100 Electrical Energy Tax	5,179,013	4,707,000	4,824,659.30	117,659.30	2.50%
GF1150 Wholesale Energy Trans Tax	3,856,112	3,870,000	3,864,771.40	(5,228.60)	-0.14%
GF1200 Railroad Car Tax	2,063,981	2,166,000	2,099,454.00	(66,546.00)	-3.07%
GF1300 Individual Income Tax	866,658,538	852,615,000	815,138,192.58	(37,476,807.42)	-4.40%
GF1400 Inheritance Tax	122,148	113,000	217,096.64	104,096.64	92.12%
GF1500 Metal Mines Tax	10,774,242	6,777,000	5,992,922.53	(784,077.47)	-11.57%
GF1700 Oil Severance Tax	149,993,826	94,769,000	100,490,970.82	5,721,970.82	6.04%
GF1800 Public Contractor's Tax	5,062,659	4,058,000	5,929,998.52	1,871,998.52	46.13%
GF1850 Rental Car Sales Tax	3,157,239	3,118,000	2,904,339.93	(213,660.07)	-6.85%
GFxxxx Property Tax	205,043,752	214,615,000	217,042,056.90	2,427,056.90	1.13%
GF2150 Lodging Facilities Sales Tax	13,389,534	13,109,000	12,477,460.56	(631,539.44)	-4.82%
GF2200 Telephone Tax	-	-	-	-	-
GF2250 Retail Telecom Excise Tax	22,350,323	21,597,000	22,250,382.96	653,382.96	3.03%
GF2300 Tobacco Tax	4,698,888	4,710,000	4,990,496.77	280,496.77	5.96%
GF2400 Video Gaming Tax	63,134,000	66,554,000	62,458,105.72	(4,095,894.28)	-6.15%
GF2500 Wine Tax	1,829,311	1,942,000	1,936,051.95	(5,948.05)	-0.31%
GF2600 Institution Reimbursements	15,334,683	14,782,000	14,100,804.26	(681,195.74)	-4.61%
GF2650 Highway Patrol Fines	4,049,390	4,052,000	4,179,882.17	127,882.17	3.16%
GF2700 TCA Interest Earnings	30,782,748	16,507,000	15,506,889.44	(1,000,110.56)	-6.06%
GF2900 Liquor Excise Tax	14,925,057	15,787,000	12,650,901.71	(3,136,098.29)	-19.87%
GF3000 Liquor Profits	8,775,000	8,651,000	7,250,000.00	(1,401,000.00)	-16.19%
GF3100 Coal Trust Interest Earnings	28,854,611	29,312,000	26,958,377.73	(2,353,622.27)	-8.03%
GF3300 Lottery Profits	11,028,563	10,275,000	10,136,213.48	(138,786.52)	-1.35%
GF3450 Tobacco Settlement	3,807,570	3,956,000	4,127,609.08	171,609.08	4.34%
GF3500 U.S. Mineral Leasing	36,388,559	24,885,000	31,573,363.66	6,688,363.66	26.88%
GF3600 All Other Revenue	<u>38,435,655</u>	<u>35,850,000</u>	<u>31,923,499.41</u>	<u>(3,926,500.59)</u>	-10.95%
Grand Total	\$1,953,539,835	\$1,844,604,000	\$1,807,967,633	(\$36,636,367)	-1.99%

* plus impacts of enacted legislation

The next section of the report discusses some of the available details for the larger revenue groups.

DISCUSSION OF SELECTED GROUPINGS FOR FISCAL 2009

Figure 2

FY 2009 General Fund Revenue Estimate Differences By Selected Groupings In Millions				
Revenue Groups	% of Actual	HJ 2 Estimate	Actual Collections	Difference
Individual Income Taxes	45.09%	852.615	815.138	(37.477)
Consumption Taxes	8.42%	161.870	152.237	(9.633)
Vehicle Fees/Taxes	5.79%	112.419	104.678	(7.741)
Interest Earnings	2.35%	45.819	42.465	(3.354)
Corporation Income Taxes	9.20%	157.284	166.355	9.071
Natural Resource Taxes	8.36%	138.841	151.085	12.244
Remaining Sources	20.80%	375.756	376.010	0.254
Totals		\$1,844.604	\$1,807.968	(\$36.636)

consumption taxes (grouping of beer, cigarette, rental car, lodging, tobacco, video, wine, liquor excise, liquor profits, and lottery profits), vehicle fees/taxes and interest earnings (grouping of TCA interest and coal trust interest) were all below the estimates. Corporation income taxes and natural resource taxes (grouping of coal, oil and gas, metals, and royalties) were above the estimates.

The following section of the report addresses some of the key general fund revenue sources that were monitored closely during the regular session. These sources are insurance premium tax, individual income tax, corporation income tax, oil and gas production tax, video gaming tax, and TCA investment earnings. These sources were chosen because of their vulnerability to the economic recession and the discussion these sources received during the past legislative session.

Insurance Tax

During the session, insurance tax collections appeared to be lagging the HJ 2 revenue estimate. Since some insurance coverage may be viewed as discretionary, combined with reduced new car sales and housing starts, it was reasonable to expect insurance tax revenues to decline during an economic recession. Insurance tax revenue collections were actually \$160 thousand (0.32 percent) above the HJ 2 estimate. The decrease in collections from FY 2008 (shown in Figure 1) is due to the passage of I 155, the Montana Healthy Kids Initiative.

Individual Income Tax

Based on final accounting data for FY 2009, individual income tax collections were below estimates contained in HJ 2 by \$37.5 million. Net collections (gross collections less refunds) were 5.9 percent below net collections for FY 2008 or a decrease of \$51.5 million. The 61st Legislature assumed the growth rate to be a negative 1.6 percent from the FY 2008 amount or a decline of \$14.0 million. This decline was anticipated because of the effects of the economic recession.

Since about 60 percent of total income reported on state tax returns reported for tax year 2007 was from wage and salary income, a review of this income component can provide some insight to future collection patterns. As assumed in HJ 2, the wage and salary growth rate between calendar years 2008 and 2009 was estimated to be 0.75 percent. According to the Bureau of Economic Analysis (BEA) first quarter data indicate growth at 1.2 percent - slightly above the assumed rate shown in HJ 2.

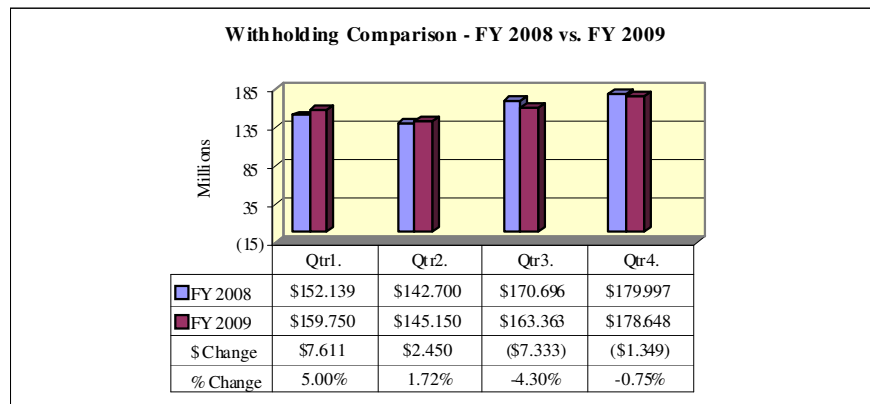
Figure 3 shows the accounting details of individual income tax collections of FY 2009 compared to the totals for FY 2008. Since withholding tax collections could be a proxy of total wage growth, the positive 0.21 percent growth from last year would indicate wages may be increasing but not as rapidly as the BEA data would suggest.

Figure 3

Individual Income Tax Comparison				
Revenue Code & Description	Final Fiscal 2008	Final Fiscal 2009	Difference	Percent Change
510101 Withholding Tax	645,532,404.52	646,910,709.00	1,378,304.48	0.21%
510482 Mineral Royalty WH Tax	12,426,153.25	17,574,260.85	5,148,107.60	41.43%
510102 Estimated Tax	250,705,012.40	247,228,513.03	(3,476,499.37)	-1.39%
510103 Current Year I/T	182,219,742.98	131,893,651.22	(50,326,091.76)	-27.62%
510105 Income Tax - Audit Collections	30,636,653.00	34,743,381.00	4,106,728.00	13.40%
510106 Income Tax Refunds	<u>(254,861,428.26)</u>	<u>(263,212,322.52)</u>	<u>(8,350,894.26)</u>	<u>3.28%</u>
Totals	\$866,658,537.89	\$815,138,192.58	(\$51,520,345.31)	-5.94%
Percent of Actual/Estimated	100.00%	95.83%		

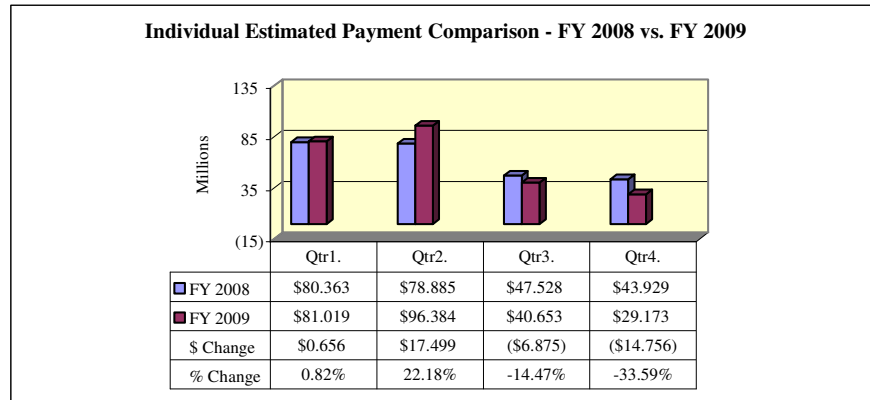
Figure 3a shows a comparison of withholding tax collections between FY 2008 and 2009 by fiscal quarter. During the first quarter of FY 2009 (July through September), withholding collections were above last year by 5.0 percent. This growth rate slowed to 1.7 percent for the second quarter (October through December) and dropped below last year during the third quarter (January through March) to negative 4.3 percent. The fourth quarter (April through June including the withholding accrual) improved somewhat but was still 0.8 percent below last year. As stated above, withholding taxes can be a good indicator of the growth in wage and salary income for Montana. If the reduction observed in the third and fourth quarter of FY 2009 continues for an extended period of time, the HJ 2 assumption for wage growth of 0.75 percent from calendar 2008 to 2009 may be too optimistic. Since 60 percent of total income reported on state tax returns is from wage and salary income, even a small change in the wage growth assumption can significantly impact the revenue estimate for individual income tax collections.

Figure 3a



Estimated payments were \$3.5 million (1.4 percent) below last year. Review of this data by quarter shows good growth in estimated payments between the first and second quarters of FY 2009. The last two quarters of FY 2009, however, show an entirely different picture. As shown in Figure 3b, estimated payments as compared to FY 2008 have declined by 14.5 and 33.6 percent, respectively for the last two quarters of FY 2009.

Figure 3b



With a substantial drop in the equity markets, historical low interest rates, reductions in corporate profitability, and the beginning of a new calendar year (a new reporting period for the taxpayer), it is not surprising to observe a significant reduction in estimated payments. The trends shown in Figure 3b are consistent with our office statements during the legislative session.

When all of the accounting categories are added together, total individual income tax collections were \$51.5 million below FY 2008 amounts. Since FY 2009 collections were estimated to be \$14.0 million below FY 2008 amounts, the HJ 2 individual income tax estimate was overstated by \$37.5 million for FY 2009. If this trend continues into the 2011 biennium, total individual income tax collections could be overstated by \$112.5 million for the three-year period.

Corporation Income Tax

Corporation income tax receipts for FY 2009 were above the estimate contained in HJ 2. Net collections (gross collections less refunds) were 3.8 percent or \$6.0 million above the net collections for FY 2008. The 61st Legislature assumed the FY 2009 growth rate to be a negative 1.9 percent or \$3.1 million below the FY 2008 amount. Figure 4 shows specific details of corporation income tax collections for FY 2009 compared to the FY 2008 amounts.

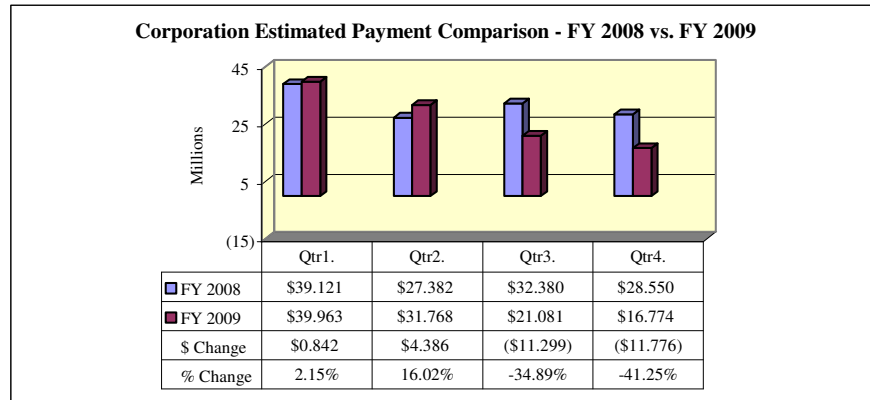
The strength in collections can be explained by the auditing efforts of the DOR and the resulting unusual high audit collections for FY 2009. Total audit collections were \$31.0 million in FY 2009 compared to \$16.9 million in FY 2008. If the audit collections are removed from FY 2008 and 2009 totals, then the trend for the remaining collections are a negative 5.7 percent, a decline rate greater than estimated in HJ 2.

Figure 4

Corporation Income Tax Comparison				
Revenue Code & Description	Final Fiscal 2008	Final Fiscal 2009	Difference	Percent Change
510501 Corporation Tax	39,473,129.82	45,608,754.97	6,135,625.15	15.54%
510505 Corporation Tax Estimated Paym	127,433,438.78	109,585,667.24	(17,847,771.54)	-14.01%
510502 Corporation Tax Refunds	(23,439,303.89)	(19,881,361.96)	3,557,941.93	-15.18%
510503 Corporation Tax-Audit Collect.	<u>16,874,522.00</u>	<u>31,041,454.00</u>	<u>14,166,932.00</u>	83.95%
Totals	\$160,341,786.71	\$166,354,514.25	\$6,012,727.54	3.75%
Percent of Actual/Estimated	100.00%	99.58%		

Further review of tax payment detail by corporation provides some additional insight to estimated payments. This data show growth in estimated payments between the first and second quarters of FY 2009. Like individual income tax estimated payments, collections for the last two quarters of FY 2009 show an entirely different picture. With announced job layoffs, business closures and/or cutbacks, significant consumer spending reductions, and construction plummeting, estimated payments have declined significantly when compared to the previous year. As shown in Figure 4a, estimated payments as compared to FY 2008 have declined by 34.9 and 41.3 percent, respectively for the last two quarters of FY 2009.

Figure 4a



Since FY 2009 collections were estimated to be \$3.1 million below FY 2008 amounts, the HJ 2 corporation income tax estimate was understated by \$9.1 million for FY 2009. Based on the decline in estimated payments for the last two quarters of FY 2009, this understatement is not expected to continue into the 2011 biennium. Total corporation income tax collections for the 2011 biennium may be below the HJ 2 estimate if estimated payments follow a similar pattern to the last two quarters of FY 2009 and audit collections decline from the historical high amounts of FY 2009.

Oil and Gas Production Tax

Total oil and gas production tax collections were \$49.5 million (33.0 percent) below last year. A decrease in oil and gas production tax was expected as prices have plummeted from the highs of a year ago. Montana oil prices averaged \$82.34 per barrel for the first ten months of FY 2008 versus \$60.73 per barrel for the first ten months (latest available) of FY 2009. This information is as reported by the US Department of Energy, Energy Information Administration (EIA). If Montana prices remain at the April level for May, and June, the average price for FY 2009 will be \$58.07 per barrel. The oil price assumption contained in HJ 2 for FY 2009 is \$54.36 per barrel. This higher price explains why FY 2009 collections were \$5.7 million higher than estimated in HJ 2.

Production amounts as reported on the tax returns for FY 2009 will not be available until fall after the DOR has input the information into their computer system. At this time, there is no tax return production numbers available for FY 2009. Production amounts for calendar 2008 declined by 9.5 percent from calendar 2007. This information is as reported by the Board of Oil and Gas.

Video Gaming Tax

Video gaming taxes were \$4.1 million (6.2 percent) below the HJ 2 estimate for FY 2009. This decrease was noted during the session but it was premature to assess the trend until further collection activity was recorded on the state accounting system (SABHRS). The assumption contained in HJ 2 was for revenues to increase by 5.4 percent from FY 2008 to FY 2009. If the FY 2009 trend continues into the 2011 biennium, video gaming tax collections could be overstated by \$12.3 million for the three-year period.

TCA Interest Earnings

Treasury cash account (TCA) interest earnings for FY 2009 were \$15.3 million (49.6 percent) below FY 2008. The HJ 2 estimate assumed these earnings would decline by \$14.3 million or 46.4 percent. The decrease was anticipated because of the significant reduction in short-term interest rates expected to occur during FY 2009. According to the Montana Board of Investments, the short-term investment portfolio (STIP) yield averaged 0.78 percent for June 2009. The assumption contained in HJ 2 was for the TCA interest rate to average 2.0 percent for FY 2009. Information from the Board of Investments shows the average TCA rate as of the end of May at 2.1 percent. Because the assumed interest rate is about equal to the year to date rate, the average daily investable balance must be lower than anticipated. Investable balance information will be available to our office at a later date.

FISCAL 2009 PRELIMINARY ENDING FUND BALANCE

When the 61st Legislature adjourned in April, the ending fund balance in the general fund account for FY 2009 was estimated to be \$369.1 million. Preliminary information from the Department of Administration, State Accounting Division, shows the unreserved ending fund balance of \$392.0 million or \$22.9 million more than anticipated. A portion of this balance is obligated because of appropriations established in FY 2009 that are authorized to be reestablished (called continuing appropriations) in FY 2010. The amount to be reauthorized (\$20.5 million) is the unexpended balance of these appropriations at the end of FY 2009. When these continuing appropriations are included in the fund balance calculation, the preliminary balance is reduced to \$371.5 million or only \$2.4 million more than anticipated by the 61st Legislature.

While general fund revenue collections were \$36.6 million less than anticipated, disbursements were also less than anticipated. By state statute, if an appropriation is not authorized to “continue” into the next biennium, then the unexpended appropriation balance remains in the account, in this case the general fund. The combined impact of less revenue, less disbursements, and continuing appropriations resulted in a fund balance within \$2.4 million of the budgeted balance. The remaining difference will be researched and reported in a subsequent report.

SUMMARY

Total general fund revenue collections for FY 2009 were below the HJ 2 revenue estimate by \$36.6 million. The focus of this analysis was on the major revenue sources especially those sources that were monitored closely during the legislative session. Since individual income tax is the predominate source of revenue in the general fund account, a small percentage change in this source can have a significant impact on total general fund revenues. As detailed in the report, there are concerns over the trends observed for the last two quarters of FY 2009 for withholding taxes and estimated payments. As expressed by our office during the session, a prolonged period of negative growth into the 2011 biennium could potentially reduce the general fund balance to a level that is unacceptable by the legislature.

The obvious question this report generates is, “What does this information indicate for FY 2010 and beyond?” Current trends portray a “gloomy” outlook for FY 2010 especially for individual and corporation income taxes. Conversely, natural resource taxes, especially oil and coal, are exceeding expectations and may help buffer some of the potential downturns in individual and corporation income taxes. Regardless, a thorough analysis of the underlying economic conditions is imperative. The economic recession, housing downturn, commodity prices, and consumer sentiment, etc. are all factors that will shape the outlook for future revenue collections. Without this analysis, erroneous conclusions could easily be assumed that may lead to inappropriate fiscal policy during the next legislative session.

From a fund balance perspective, the preliminary ending fund balance for FY 2009 is very close to what was anticipated with the inclusion of the continuing appropriations. This means the starting point for the 2011 biennium is approximately equal to the budgeted amount by the 61st Legislature. Therefore, revenue estimate variations, reversions, supplemental appropriations, and litigation outcomes will be the factors that could change the 2011 ending fund balance of \$282.4 million.

While your staff will continue to monitor revenue trends, a thorough analysis of current revenue trends with an eye toward the future has begun in preparation for the revenue estimate process of the Revenue and Transportation Interim Committee (RTIC). This analysis will be the basis for our revenue estimate recommendations to RTIC for the 2013 biennium.